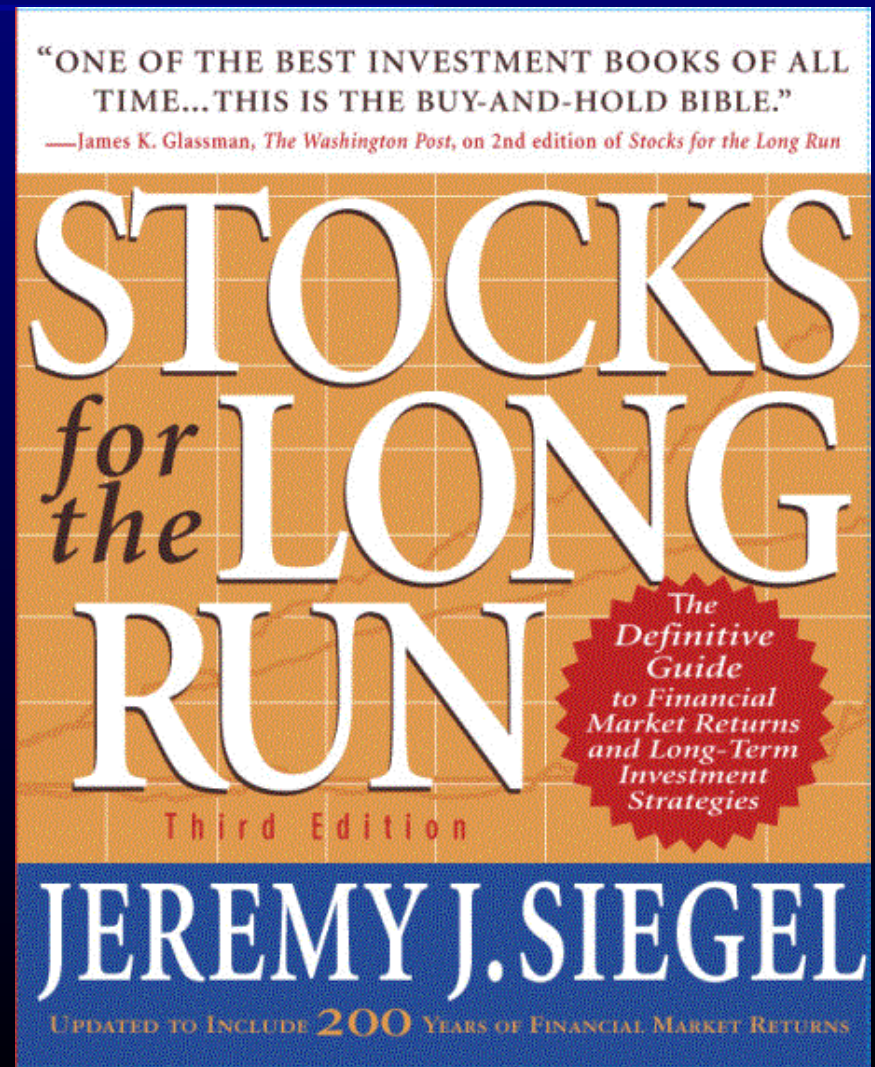
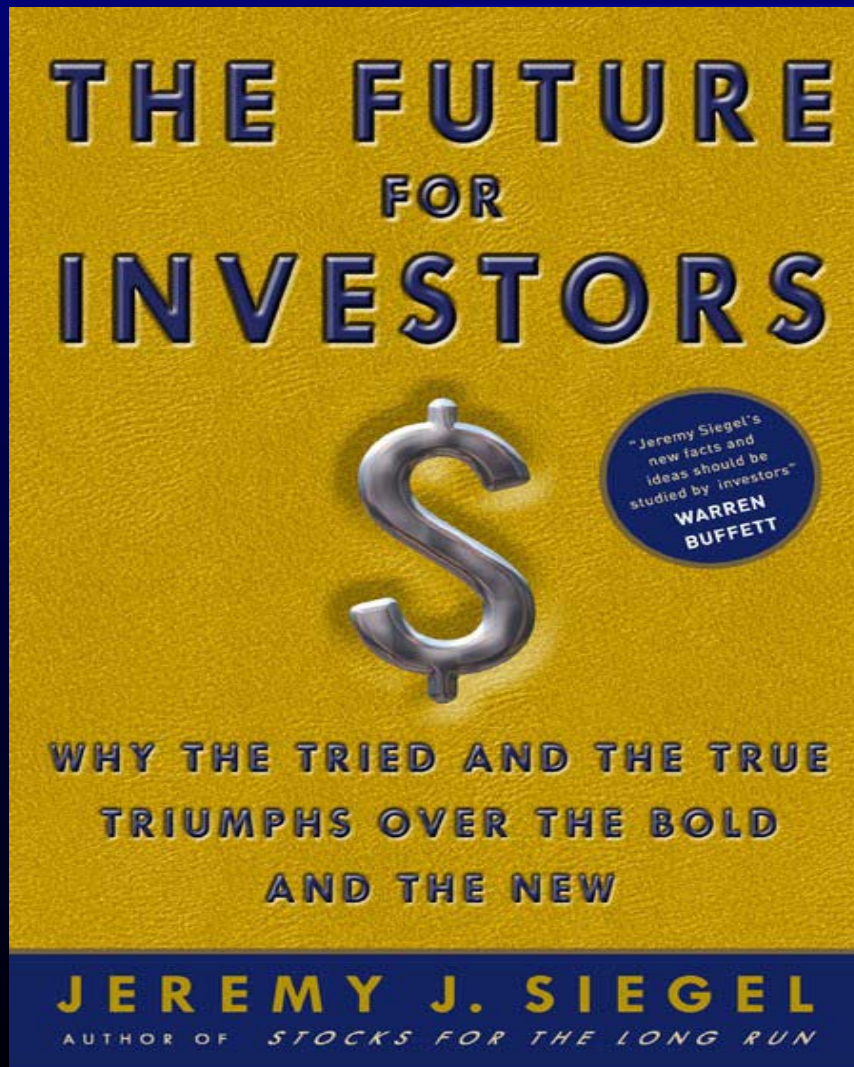


Bull vs Bear Debate

Prof. Jeremy J. Siegel ~ The Wharton School

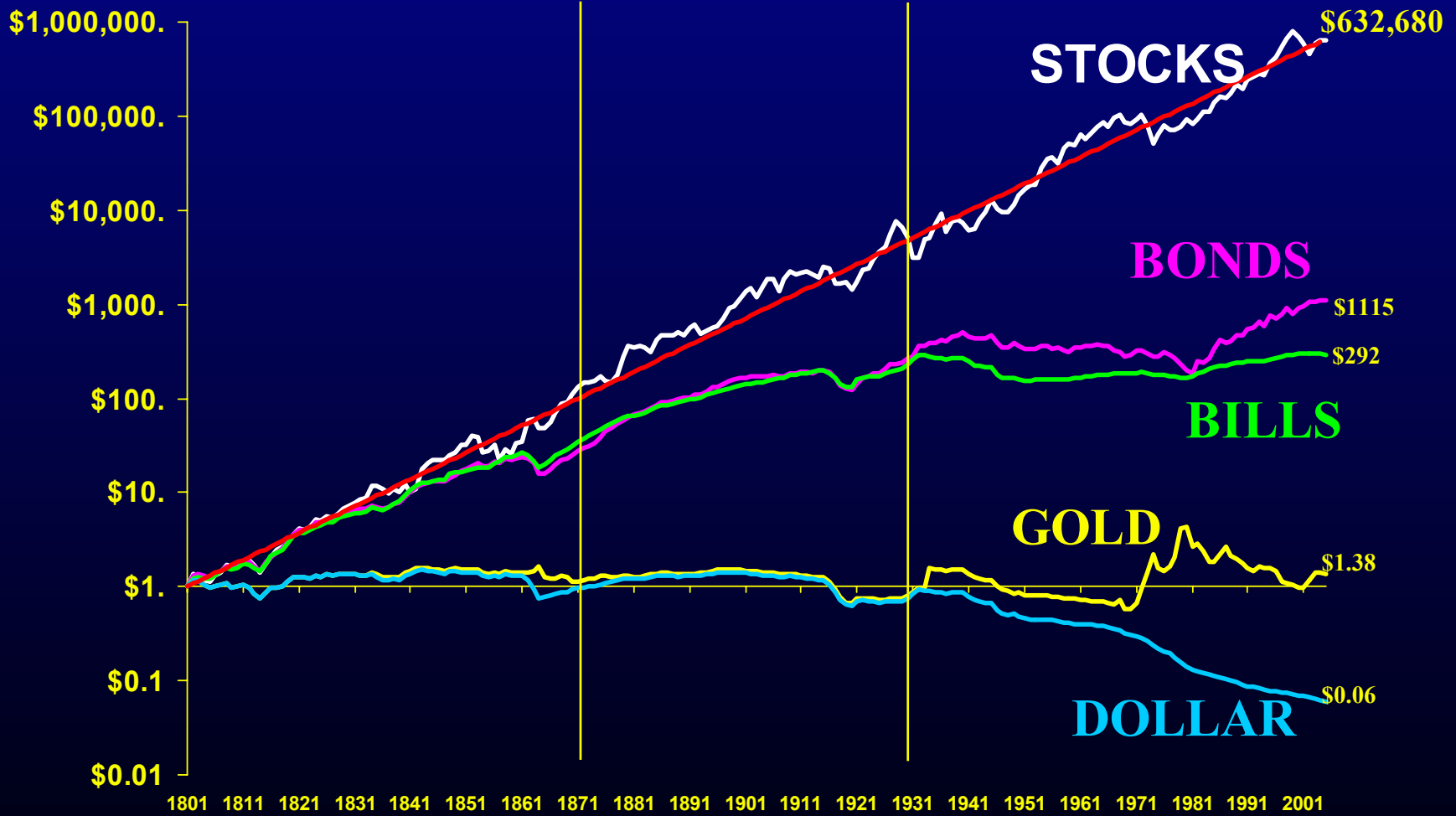
SIA Annual Meeting ~ November 10, 2005



The Verdict of History

Total Real Return Indices

January 1802 – June 30, 2005



Annual Stock Market Returns

<u>Updated through</u> <u>June 30, 2005</u>		Real Returns
Long-Term	1802-2005	6.8%
Major Sub-Periods	I 1802-1870	7.0%
	II 1871-1925	6.6%
	III 1926-2005	6.7%
Post-War Periods	1946-2005	6.8%
	1946-1965	10.0%
	1966-1981	-0.4%
	1981-1999	13.6%
	1984-2005	8.9%

Annual Bond Market Returns

<u>Updated through</u> <u>June 30, 2005</u>		Real Returns
Long-Term	1802-2005	3.5%
Major Sub-Periods	I 1802-1870	4.8%
	II 1871-1925	3.7%
	III 1926-2005	2.3%
Post-War Periods	1946-2005	1.5%
	1946-1965	-1.2%
	1966-1981	-4.2%
	1981-1999	8.4%
	1984-2005	7.2%

Projected Equity Returns (Nov. 4)

- Earnings Yield, or 1/P-E ratio, is excellent long-term predictor of real stock returns.
- Average P-E ratio in last 130 years = 15; average earnings yield 6.7%.
- S&P 500 Estimate of next 12 months *operating* earnings \$84.44 (end 3Q06)
- S&P 500 (Nov. 4) = 1216. P-E ratio 14.40, earning yield = 6.94%.
- If you take reported earnings, estimate 77.74, for a P-E ratio of 15.64, EY of 6.39%
- If you take core earnings estimate \$75.04, P-E ratio 16.20, earnings yield 6.17%

Bond Returns and Equity Premium

- Ten year at 4.65%, 30-year at 4.84%
- If we subtract 2.5% for inflation, we get a real yield of 2.15% and 2.34%.
- TIPs yields are 2.04% and 2.08%.
- Equity Premium is 4% to 5% now.
- Expect real yields to rise about 1%
- Long-Term Equity Premium = 3%.

Rationale for Lower Equity Returns

- Greater Liquidity and ease of diversification in the equity Market
- Greater understanding by investors of the equity premium.
- Increasingly favorable taxation of equity.

Dividend yield and Earnings Growth

Reduction in Payout DOES lead to faster earnings growth

	Real GDP Growth	Real Per-Share Earnings Growth	Real Per-Share Dividend Growth	Dividend Yield*	Payout Ratio*
1871-2005	3.88%	1.80%	1.24%	4.58%	58.30%
1871-1945	4.51%	0.66%	0.74%	5.29%	66.78%
1946-2005	3.10%	3.23%	1.86%	3.53%	51.71%

* Denotes median.

From Before World War II to after, dividend yield dropped 176 bps and earnings growth increased 257 bps.

Earnings Growth and Payout Ratio

- **Current Dividend Yield (S&P 500) = 2.1%.**
- **Current payout ratio about one-third.**
- **This will lead to faster earnings growth**
- **Per share earnings (EPS) growth can exceed GDP growth.**
- **As firms repurchase shares, EPS rises even if there isn't any aggregate earnings growth.**
- **The S&P 500 divisor has fallen from 9236 to 9018 over past 2 years, after increasing strongly in the 1990s.**

Conclusions

- We are in the middle of fair market value range for stocks.
- Bond yields unusually low due to world savings glut, reduced investment demands, and increasing risk aversion of aging population and pension funds.
- But increasing world economic growth will push real yields upward and reduce equity premium without depressing stock prices.

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2 March 2005


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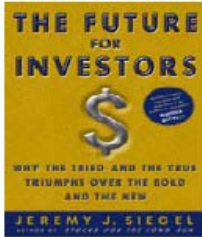
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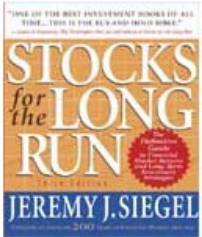
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